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TO: Education Task Force

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RE: 150% of Assessed Value Rule (SDCL 10-6-74)

The 150% rule.
The 150% rule excludes from the valuation process any sale of ag or non-ag property where the property sold for more than 150% of its assessed value. This means a county assessor can't use that sale as a basis for valuing any real property in the county.

SDCL 10-6-74. Restrictions on using certain real property to value other real property--Exclusion from sales ratio study. Any real property which sells for more than one hundred fifty percent of its assessed value, may not be used for the purpose of valuing other real property. The sale of any real property which is not used for the purpose of valuing other real property pursuant to this section may not be used in any sales ratio study.

The 150% rule is often confused with the NonAg-Z rule. While the 150% rule is based on a property's ***assessed value***, the NonAg-Z rule is applied to property that sells for more than 150% of its ***ag income value***. A property's ag income value is calculated based on cash rent information. NonAg-Z property is (1) taxed at its sale price for one year; (2) taxed at a rate $1 higher than ag property for one year; (3) taxed like any other property after the first year; and (4) the sale is never used in the valuation process. On the other hand, property that falls under the 150% rule is still taxed the same as all other real property in the county; the rule only means the sale can't be used for valuation purposes.

The Problem.
County directors of equalization are required by law to ensure that all property is assessed at 85% of its market value. The department monitors each county's level of assessment to ensure that they are assessing all property at 85%. If the 150% rule throws out more than just a few sales within the county, the assessor's valuation process is distorted, as is the department's verification process. As a result, some counties are significantly undervaluing their property. For example some counties are taxing 85% of the value of ag land within the county while other counties are taxing less than half of the value of ag land within the county.

These disparities cause two problems. First, they impact the distribution of state aid to education dollars. Distribution of state aid dollars to school districts is based on the assumption that all counties are taxing at 85% of full and true value. Counties that tax at less than 85% appear poorer than they actually are. Therefore, they get more state aid for education dollars than they should.

In addition, because some value isn't being taxed, the tax rates imposed on property throughout the state are higher than they otherwise would be. The school general fund levy rates are set by the legislature each year based upon the amount of taxable property in the state. Essentially, to figure out the rates, they look at the total taxable property in the state, and calculate what tax rate they have to apply to that property so that the school districts have enough money. Those rates could be lowered if the 150% of assessed value rule wasn't hiding some value from the tax system.

The Solution.
We estimate that $4.0 billion of value is currently not being taxed because of the 150% rule. The total value of all real property within the state is about $40 billion. Adding the $4.0 billion of value back into the property tax base would have significant statewide effects on property tax rates. We calculate that the school general fund levy rates could be lowered as follows:

	Current Rates	Estimated Rates
Ag	$3.19/$1,000	$2.96/$1,000
Owner-Occupied	$5.13/$1,000	$4.76/$1,000
Other (commercial)	$11.00/$1,000	$10.21/$1,000

HB 1151 from the 2006 legislature proposed a gradual phase-out of the 150% rule. A phase-out would eventually bring all counties into compliance with the requirement that they tax 85% of the value within the county. In addition, a phase-out would eliminate the current disparities between counties in valuation, correct the overpayment of state aid to education, and facilitate the lowering of property tax rates statewide.

Costs of Fixing the Problem.
When the phase-out is implemented, property values will go up in some counties. Property owners in counties whose values have been significantly distorted by the 150% rule will face significant tax increases.